



BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission

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TOM FORESE – Chairman
BOB BURNS
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BOYD DUNN

IN THE MATTER OF THE
APPLICATION OF ARIZONA PUBLIC
SERVICE COMPANY FOR A HEARING
TO DETERMINE THE FAIR VALUE OF
THE UTILITY PROPERTY OF THE
COMPANY FOR RATEMAKING
PURPOSES, TO FIX A JUST AND
REASONABLE RATE OF RETURN
THEREON, TO APPROVE RATE
SCHEDULES DESIGNED TO DEVELOP
SUCH RETURN.

Docket No. E-01345A-16-0036

IN THE MATTER OF FUEL AND
PURCHASED POWER PROCUREMENT
AUDITS FOR ARIZONA PUBLIC
SERVICE COMPANY.

Docket No. E-01345A-16-0123


NOTICE OF FILING DIRECT
TESTIMONY (SETTLEMENT
AGREEMENT) OF KEVIN C.
HIGGINS ON BEHALF OF
FREEPORT MINERALS
CORPORATION, ARIZONANS
FOR ELECTRIC CHOICE AND
COMPETITION, CALPINE
ENERGY SOLUTIONS, LLC,
CONSTELLATION
NEWENERGY, LLC AND
DIRECT ENERGY BUSINESS,
LLC

Freeport Minerals Corporation, Arizonans for Electric Choice and Competition (collectively "AECC"), Calpine Energy Solutions, LLC ("Calpine"), Constellation NewEnergy, LLC, ("NewEnergy") and Direct Energy Business, LLC ("Direct") hereby submit the Direct Testimony (Settlement Agreement) of Kevin C. Higgins on behalf of AECC, Calpine, NewEnergy and Direct in the above captioned Docket.


1 RESPECTFULLY SUBMITTED this 3rd day of April, 2017.

2 FENNEMORE CRAIG, P.C.

3
4 By


Patrick J. Black
2394 E. Camelback Road, Ste. 600
Phoenix, AZ 85016-3429
pblack@fclaw.com
Attorneys for Freeport Minerals Corporation
and Arizonans for Electric Choice and Competition

5
6
7
8
9 By:


Lawrence V. Robertson, Jr.
Attorney for Calpine Energy Solutions, LLC,
Constellation NewEnergy, LLC, and Direct Energy
Business, LLC
tubaclawyer@aol.com

10
11
12
13
14 **ORIGINAL and 13 COPIES** of the foregoing
FILED this 3rd day of April, 2017 with:

15 Docket Control
16 ARIZONA CORPORATION COMMISSION
17 1200 West Washington
18 Phoenix, Arizona 85007

19 **COPY** of the foregoing was hand delivered, mailed,
20 emailed this 3rd day of April, 2017 to:

21 Andrew Kvesic, Chief Legal Counsel
22 Legal Division
23 Arizona Corporation Commission
24 1200 West Washington Street
25 Phoenix, Arizona 85007
26 LegalDiv@azcc.gov
MScott@azcc.gov
CHains@azcc.gov
WVanCleve@azcc.gov
EAbinah@azcc.gov

1 EAbinah@azcc.gov
2 TFord@azcc.gov
3 EVanEpps@azcc.gov
4 CFitzsimmons@azcc.gov
5 KChristine@zcc.gov

6 Thomas A. Loquvam
7 Thomas L. Mumaw
8 Melissa M. Krueger
9 Pinnacle West Capital Corporation
10 400 North 5th Street, MS 8695
11 Phoenix, Arizona 85004
12 Thomas.Loquvam@pinnaclewest.com
13 Thomas.Mumaw@pinnaclewest.com
14 Melissa.Krueger@pinnaclewest.com
15 Amanda.Ho@pinnaclewest.com
16 Debra.Orr@pinnaclewest.com

17 **COPY** mailed/mailed
18 this 3rd day of April, 2017 to:

19 Parties of Record

20 By: 
21 12747410

BEFORE THE ARIZONA CORPORATION COMMISSION

In the Matter of the Application of Arizona
Public Service Company for a Hearing to
Determine the Fair Value of the Utility Property
of the Company for Ratemaking Purposes, to Fix
a Just and Reasonable Rate of Return Thereon,
to Approve Rate Schedules Designed to Develop
Such Return

Docket No. E-01345A-16-0036

In the Matter of Fuel and Purchased Power
Procurement Audits for Arizona Public Service
Company

Docket No. E-01345A-16-0123

Direct Testimony of Kevin C. Higgins

on behalf of

Freeport Minerals Corporation

Arizonans for Electric Choice & Competition

Calpine Energy Solutions, LLC

Constellation NewEnergy, LLC

Direct Energy Business, LLC

Settlement Agreement

April 3, 2017

DIRECT TESTIMONY OF KEVIN C. HIGGINS

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1 **DIRECT TESTIMONY OF KEVIN C. HIGGINS**

2

3 **INTRODUCTION**

4 **Q. Please state your name and business address.**

5 A. My name is Kevin C. Higgins. My business address is 215 South State
6 Street, Suite 200, Salt Lake City, Utah, 84111.

7 **Q. By whom are you employed and in what capacity?**

8 A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies
9 is a private consulting firm specializing in economic and policy analysis
10 applicable to energy production, transportation, and consumption.

11 **Q. Are you the same Kevin C. Higgins who previously filed testimony on the**
12 **subjects of Revenue Requirement and Cost of Service/Rate Design in this**
13 **proceeding?**

14 A. Yes, I am.

15 **Q. What parties are sponsoring your Settlement testimony?**

16 A. My Settlement testimony is sponsored by Freeport Minerals Corporation;
17 Arizonans for Electric Choice and Competition;¹ Calpine Energy Solutions, LLC
18 ("Calpine Solutions"); Constellation NewEnergy, LLC; ("Constellation
19 NewEnergy"); and Direct Energy Business, LLC ("Direct Energy").

¹ Henceforth in this testimony, Freeport Minerals Corporation and Arizonans for Electric Choice and Competition collectively will be referred to as "AECC."

1 **OVERVIEW AND CONCLUSIONS**

2 **Q. What is the purpose of your settlement testimony?**

3 A. I am testifying in support of the Proposed Settlement Agreement
4 (“Settlement Agreement”) filed by the ACC Staff on behalf of the Agreement’s
5 Signatories on March 27, 2017. The Settlement Agreement provides a
6 comprehensive resolution of the issues in the Arizona Public Service Company
7 (“APS”) general rate case.

8 **Q. What is your recommendation to the Commission with respect to the**
9 **Settlement Agreement?**

10 A. I recommend that the Settlement Agreement as submitted by the
11 Signatories be approved by the Commission. In my opinion, the Settlement
12 Agreement produces just and reasonable rates and is in the public interest.

13 **Q. Have AECC, Calpine Energy Solutions, Constellation NewEnergy Inc, and**
14 **Direct Energy signed the Settlement Agreement?**

15 A. Yes. The Settlement Agreement is a package that was crafted after
16 extensive negotiations among many parties over several weeks. Each of the
17 parties co-sponsoring my testimony is recommending adoption of each provision
18 in the Settlement Agreement as a package deal.

19 **Q. How is your testimony in support of the Settlement Agreement organized?**

20 A. First, I offer some comments on the overall Settlement Agreement. I
21 follow that discussion with some specific comments on certain provisions of the
22 Settlement Agreement that are of particular interest to AECC, Calpine Solutions,
23 Constellation NewEnergy, and Direct Energy.

1 **OVERALL AGREEMENT**

2 **Q. Please provide a general overview as to why you believe the Settlement**
3 **Agreement is in the public interest and should be adopted.**

4 A. The Settlement Agreement provides a comprehensive resolution to the
5 extensive number of issues being addressed in this general rate case. The final
6 agreement is a compromise negotiated by many parties that reflects a balancing of
7 interests among the very diverse set of stakeholders that participated in the case.
8 AECC, one of the co-sponsors of my testimony, is a customer group. The other
9 co-sponsors of my testimony, Calpine Solutions, Constellation NewEnergy, and
10 Direct Energy Calpine Energy Solutions are Generation Service Providers
11 ("GSPs") serving AG-1 customers under APS's current tariff. My assessment of
12 the Settlement Agreement is from the vantage point of customers in general, with
13 a particular emphasis on the perspective of business customers, including those
14 customers who are interested in continuing to procure their generation from
15 competitive suppliers, i.e., GSPs. In my opinion, the Settlement Agreement treats
16 APS's customers fairly.

17 In providing a comprehensive resolution of the issues in the APS general
18 rate case, the Settlement Agreement offers a number of benefits to customers,
19 including the following:

- 20 • APS's non-fuel, non-depreciation revenue increase is reduced by \$58.96 million
21 relative to APS's request in its filed case.
- 22 • APS agrees to a rate case stay-out, pursuant to which the Company will not file a
23 new general rate case prior to June 1, 2019.

- The AG-1 buy-through program is retained and converted, in a somewhat modified form, into the AG-X program, which will continue to provide access to competitively-provided generation for interested business and public sector customers.

Taken as a whole, the Settlement Agreement constitutes a reasonable resolution to the overall case by providing meaningful protections and benefits to customers, while giving APS a reasonable opportunity to earn a fair return on its investment.

DISCUSSION OF SPECIFIC ISSUES

Q. In your direct testimony on behalf of AECC, you challenged several aspects of APS's filing that have been included in the settlement package, such as deferral of costs for the installation of selective catalytic reduction equipment at Four Corners Units 4 and 5 and the Ocotillo Modernization Project. Have you changed your testimony on these matters?

A. I have not changed my opinion on these topics as isolated matters or when these topics are viewed in the context of APS's initial application. However, the overall settlement package contains enough benefits to customers that I have concluded that it is in the public interest to move forward with this entire package, including certain items with which I may disagree in isolation. Such is the nature of negotiation and compromise.

With respect to the deferrals in question, I note that the Settlement Agreement requires APS to stay out from general rate cases until June 1, 2019. I participate in general rate cases around the country; in many jurisdictions they

1 have become annual events. A stay-out in excess of two years conveys a
2 significant benefit to customers in terms of rate stability and rate certainty.

3 APS's willingness to adhere to a stay-out of this length, as well as other
4 customer benefits in the Settlement Agreement, including retention of the buy-
5 through program, influenced AECC's willingness to compromise from its
6 litigation position on the deferrals and other issues in this case.

7 **Q. In your direct testimony on behalf of AECC, you recommended that APS's**
8 **net revenue requirement be reduced by \$81.33 million. Does the Settlement**
9 **Agreement adequately address the revenue requirement issues you raised in**
10 **your direct testimony?**

11 A. Viewed as a whole, yes. As I noted above, the Settlement Agreement
12 reduces APS's proposed non-fuel, non-depreciation revenue requirement by
13 \$58.96 million relative to APS's request in its filed case. It also reduces APS's
14 proposed depreciation expense by \$20 million. When these two items are taken
15 together, the final result is close to the recommended reduction in my direct
16 testimony.

17 **Q. In your direct testimony on behalf of AECC, you recommended adjustments**
18 **to APS's proposed spread of rates among classes. Does the Settlement**
19 **Agreement adequately address this issue?**

20 A. Yes. While the General Service class continues to pay significant
21 subsidies, in the context of the overall Settlement Agreement, the stipulated
22 spread of rates is reasonable.

23 **Q. In your direct testimony on behalf of AECC, Calpine Solutions, Constellation**
24 **NewEnergy, and Direct Energy, you advocated for continuation and**

1 **expansion of the AG-1 program. How does the Settlement Agreement**
2 **address the AG-1 program?**

3 A. As I noted above, the Settlement Agreement retains the AG-1 program,
4 and extends it, in a somewhat modified form, into a new AG-X program. This
5 program will continue to allow qualifying customers with aggregated monthly
6 demands of 10 MW or more to obtain alternative sources of generation to serve
7 their full power requirements through a buy-through arrangement in which APS
8 purchases the generation on behalf of the customer for a management fee. The
9 program size will continue to be limited to 200 MW. The first tranche of 100
10 MW of this amount initially will be allocated to customers with single site peak
11 demands of 20 MW or greater and load factors above 70%. If this tranche is not
12 fully subscribed during the solicitation process, the remainder would be made
13 available to other qualifying customers. The balance of the program MWs,
14 including any unused amount from the first tranche, would be available to other
15 qualifying customers on a first-come first-served basis, unless it is
16 oversubscribed, in which case it would be allocated through a lottery. However,
17 once program participation in AG-X is established, continued participation would
18 not require a new lottery.

19 **Q. Are there changes in the charges levied on AG-X customers relative to the**
20 **current AG-1 charges?**

21 Yes. Although the structure of the program charges remains very similar
22 to the present AG-1 program, under the Settlement Agreement, the program will
23 become considerably more expensive for participants. For example, the
24 management fee will increase from \$0.0006/kWh to \$0.0018/kWh. In addition,

1 there is a four-fold increase in the Capacity Reservation Charge from its current
2 level. This latter charge requires AG-X customers to pay for a portion of APS's
3 fixed generation charges despite the fact that these customers purchase their
4 generation service from a GSP. In the current program, APS's FERC demand
5 charge of \$9.233/kW charge applies to 15% of the AG-1 customer's billed
6 demand, which is equivalent to a charge of \$1.385/kW applied to 100% of an AG-
7 1 customer's billed demand.² In the Settlement Agreement, this charge increases
8 to \$5.5398/kW applied to 100% of an AG-1 customer's billed demand.

9 **Q. Why are you and the co-sponsors of your testimony agreeing to support such**
10 **large increases in these charges?**

11 A. In my direct testimony I stated that I did not oppose an increase in the
12 management fee to \$0.0012/kWh if it were cost-based, in response to arguments
13 by APS that the administrative costs of the program were greater than the current
14 \$0.0006/kWh management fee.³ The increase to \$0.0018/kWh in the Settlement
15 Agreement is the result of negotiation and compromise. Similarly, in my direct
16 testimony, I recommended that the Capacity Reservation Charge be doubled to
17 apply to 30% of AG-1 billed demand on a temporary (four-year) basis as part of a
18 transition to a permanent buy-through program, after which the charge would step
19 back down to the current 15% level.⁴ In its filed case, APS took the position that
20 if the program were to be continued, the full Capacity Reservation Charge should
21 apply to 100% of AG-1 customer billed demand, which effectively would have
22 increased the current charge nearly seven-fold. In the Settlement Agreement, the

² That is, $\$9.233/\text{kW} \times .15\% = \$1.385/\text{kW} \times 100\%$.

³ See Direct Cost-of-Service/Rate Design Testimony of Kevin C. Higgins, p. 22.

⁴ Id., pp. 14-15.

1 Signatories have agreed to a Capacity Reservation Charge of \$5.5398/kW, which
2 is equivalent to 60% of APS's FERC demand charge, applied to 100% of an AG-
3 1 customer's billed demand. This rate effectively quadruples the current charge,
4 and is the result of negotiation and compromise.

5 While these increases in charges erode some of the benefits from customer
6 participation in this program, I believe that overall this result is acceptable
7 because it allows for the continuation of a successful program that is likely to
8 continue to provide customer benefits despite these higher charges. The
9 establishment of the AG-1 program was a very customer-friendly innovation that
10 has allowed Arizona businesses and public sector entities to improve their
11 economic health by managing their power supply, risk, and cost by participating
12 in the competitive market. I believe it is important and in the public interest for
13 this program to continue into the future.

14 **Q. Why do you consider the AG-1 program to be a success?**

15 A. The program has been fully subscribed since its inception and it remains
16 fully subscribed. Further, when the initially-anticipated program term was
17 extended beyond June 30, 2016 (so that it would not expire prior to the conclusion
18 of APS's next rate case) all participants opted to remain in the program. In APS's
19 evaluation of the AG-1 program, the Company reported that program operations
20 such as power scheduling, settlements, information exchanges, and billing were
21 generally successful.⁵ Moreover, the competitive suppliers selected by customers
22 (including the GSPs co-sponsoring my testimony) have continued to provide
23 power to customers through the mechanics of the buy-through program, without

⁵ See Direct Testimony of Leland R. Snook, Attachment LRS-06DR, p. 1.

1 any failures to deliver. These are the hallmarks of a successful program.

2 Allowing customers to acquire power in the competitive market improves the
3 economic climate for Arizona businesses as well as the competitiveness of
4 Arizona businesses.

5 **Q. In APS's direct testimony in this case, the Company raised concerns**
6 **regarding the AG-1 imbalance energy charges. Was this issue resolved in the**
7 **Settlement Agreement?**

8 A. Yes. Energy imbalance charges are levied when the hourly demand
9 scheduled for a GSP deviates from its scheduled power delivery. The Signatories
10 negotiated new energy imbalance provisions that are mutually acceptable for the
11 purpose of the AG-X program.

12 **Q. Does the Settlement Agreement provide a termination date for the AG-X**
13 **program?**

14 A. No. In contrast with the AG-1 program, the AG-X program is not
15 characterized as experimental. While the Settlement Agreement does not go as
16 far as I had advocated in my direct testimony, in which I recommended that the
17 program be fully incorporated into APS's integrated resource planning process,
18 the Settlement Agreement does not design the AG-X program to be temporary.
19 Rather, like any rate schedule, its charges and parameters are subject to change in
20 the next general rate case. Further, the next general rate case may consider the
21 question of whether AG-X should be treated as a separate class in the Company's
22 cost-of-service study.

23 **Q. The Settlement Agreement provides that the PSA mitigation mechanism**
24 **remains in place, but is modified to capture \$1,250,000 per month of off-**

1 **system sales margins rather than a pro rata amount. What is the benefit of**
2 **this approach?**

3 A. The AG-X program frees up capacity and energy for APS to resell in the
4 wholesale market. The modification to the PSA mitigation mechanism provides
5 greater certainty going forward regarding the revenues produced by this
6 mechanism.

7 **Q. What is the Settlement Agreement's approach for recovering the AG-1 cost**
8 **deferral that was approved in Decision No. 75322?**

9 A. These costs would be amortized over five years from non-residential
10 customers except street and area lighting customers, consistent with the rate
11 spread in APS's filed case.

12 **Q. Do you agree that this approach to recovering the AG-1 deferral is**
13 **reasonable?**

14 A. Yes, I do. The deferral resulted when APS refrained from filing a rate
15 case as early as the Company could have under the terms of the 2012 settlement
16 agreement. The initial AG-1 tariff provided that the program would be available
17 for four years from the effective date of AG-1, unless extended by the
18 Commission. Absent Commission action, this would have resulted in program
19 termination on June 30, 2016. However, it was always anticipated that the AG-1
20 program was going to be evaluated in the next rate case following that settlement
21 agreement. Subsequently, when APS's rate case filing was delayed beyond the
22 initially-anticipated filing date, the Commission agreed to extend the AG-1
23 program to match the timing of the later filing, subject to a deferral of a portion of
24 APS costs. As all customers benefitted from the extended rate case stay-out, it is

1 reasonable for the deferral that resulted from the extension of AG-1 to be
2 recovered as proposed in the Settlement Agreement.

3 **Q. Can APS defer recovery of any unmitigated costs associated with the AG-X**
4 **program?**

5 A. No. While I believe it is unlikely that there would be any unmitigated
6 costs associated with the AG-X program, to the extent that any are incurred, the
7 Settlement Agreement specifically prohibits any deferral or collection of
8 unmitigated costs associated with the AG-X program.

9 **Q. Does this conclude your settlement testimony?**

10 A. Yes, it does.